Box I.1: **Illustrative decomposition of the 2015 GDP forecast**

The forecast for euro area GDP growth in 2015 is boosted by a conjunction of tailwinds. This box provides a rough quantification of the different factors affecting the growth outlook for this year based on simulations with the Commission's QUEST model. It should be noted however that the decomposition derived from the model is not necessarily identical with the impact of the same factors in the forecast, which incorporates expert judgement.

In view of the interlinkages between growth drivers, any breakdown can only give a rough idea of the contribution of single factors and so is somewhat rudimentary and subject to large uncertainties. But it is indicative in that it highlights the positive tailwinds boosting euro area growth at the current juncture. Therefore, the growth decomposition reported here is purely illustrative.

Potential euro area GDP growth is calculated at 0.8% in 2015, according to the agreed EU methodology. Output growth is boosted beyond this by a number of positive shocks, most prominently the decline in oil prices and more ample monetary conditions, while the stance of fiscal policy in the euro area is broadly neutral. A negative impact stems from events in Ukraine and related tensions with Russia.

Oil prices have fallen from USD 110 in June 2014 to around USD 60 at present, while in euro terms the fall has been around 30%. Lower oil prices boost households' disposable incomes and reduce firms' costs. The assumption of an only moderate rebound in oil prices implies that the positive impact on economic activity will continue for the rest of the year. For the year as a whole, this factor can raise GDP growth by around half a percentage point.

Looser monetary conditions comprise the impact of the ECB's recent non-standard policy measures on interest rates and their impact on the euro's exchange rate, taking into account the expected tightening of monetary policy in the US. In the simulations, quantitative easing affects euro area growth through a lower term premium, higher demand for riskier assets and via the exchange rate of the euro (cf. section I.1). The impact of QE on the euro's exchange rate cannot easily be disentangled from the exchange-rate impact of the less accommodative monetary policy expected in the US, reflecting the more advanced recovery, and from other factors that have affected investors' preferences. Together, these have driven the euro down by about 10% in effective terms since May 2014. The effect of more accommodative monetary conditions is estimated to be a boost to euro area growth this year of around ¾ pps. By increasing inflation expectations and thus preventing an unwarranted increase in real interest rates, QE has also accentuated the positive impact of the oil price fall on the economy. [(1)]

On the negative side, geopolitical tensions relating to Ukraine and the ensuing imposition of sanctions on Russia have had an impact on confidence and also some direct impact on trade, investment and on financial markets. [(2)] These tensions are estimated to lower growth by around ¼ pps in 2015.

The remaining residual of -0.4% reflects a variety of factors. On the downside they include the legacy of the crisis, ongoing deleveraging pressures and elevated uncertainty in the euro area. On the upside, the residual covers factors such as the acceleration of global growth and world trade, and calendar effects.

Table 1:
Euro area GDP growth decomposition

	2015
Euro area GDP growth	**1.5**
- Potential output growth	0.8
- Oil price decline	0.5
- Monetary conditions	0.8
- Geopolitical tensions	-0.2
- *Residual*	-0.4

(1) An expected increase of real interest rates with monetary policy constrained at the zero-lower-bound was one of the main reasons for assessing the impact of the oil price fall cautiously in the winter forecast.

(2) Assumed to expire in July 2015 (cf. explanations in the main text).